EATEL

July 22, 2013

The Honorable Mignon Clyburn
Acting Chairwoman
Federal Communications Commission

The Honorable Ajit Pai
Commissioner
Federal Communications Commission

The Honorable Jessica Rosenworcel
Commissioner
Federal Communications Commission

445 12th Street SW
Washington, DC 20554

RE: **Connect America Fund**, WC Docket No. 10-90
High-Cost Universal Service Support, WC Docket No. 05-337

I would like to take this opportunity to discuss the concerns that East Ascension Telephone Company ("EATEL") has with the current benchmark methods used in the calculation of High Cost Loop ("HCL") support. As you likely know, EATEL is dramatically impacted by the quantile regression analysis ("QRA") used to benchmark cost for HCL recovery. Candidly, my family and I are very surprised by the results as we have always worked hard to provide superior service to our customers through efficient network investment and operations.

I have several concerns with the QRA and its ability to provide meaningful benchmarks because of its inability to make accurate comparisons. Without serious revision, the QRA is unable to properly serve its purpose as a guide to reasonable and efficient costs of universal service. While we agree with other parties that there are many problems with the concept and execution of the QRA, I would like to discuss four main areas of particular consequence to EATEL:

1. The lack of network architecture realities and broadband availability variables
2. The inclusion of Operating Taxes as an operating cost
3. The use of Depreciation Expense to measure capital investment
4. The use of common line allocated costs

Network Architecture and Broadband Availability

About fifty years ago, on September 9, 1965, Hurricane Betsy hit South Louisiana with fierce destruction. I was 8 days old at the time and, although I don't remember the event, the effects still impact East

Ascension Telephone Company. In 1965, EATEL had an all aerial network. This network was totally destroyed by Hurricane Betsy. My family's home became "Central Command" for rebuilding the network. My parents learned a valuable lesson that, although burying telephone cable was more expensive, it paid off in the long run and better served our customers.

The prudence of our network architecture decisions was repeatedly confirmed over the last seven years when Hurricane Katrina and Hurricane Gustav directly impacted East Ascension Telephone Company's service area. We weathered the storms successfully because of the prudence of initially higher-cost infrastructure. In fact, FEMA located its "central command" in East Ascension Telephone Company's network after Hurricane Katrina. East Ascension Telephone Company served evacuees by the thousands. Our buried network served customers well and our restoration costs were minimal in light of the magnitude of the natural disaster.

In Louisiana a robust buried network designed for emergency power and weather challenges is not an operating choice, it is a necessity. However, there is no variable in the QRA that considers these real world causes of higher costs of service. There is no variable to distinguish companies with underground or aerial cable facilities. While there is a "climate" variable, it is only a frost index. There are other significant climate challenges such as high winds, water, flooding, etc. None of these important factors which demonstrably lead to EATEL's higher costs of network deployment and operation are taken into consideration by the QRA.

Likewise, well before the Commission decided that ubiquitous broadband should be a national goal, EATEL planned and invested significant resources converting our legacy copper voice network to a fiber broadband network. Today, the vast majority of our customers already enjoy high speed broadband availability in excess of the Commission's 4/1 Mbp requirements. Once again though, the QRA does not consider the extent of broadband availability when benchmarking network costs. Nor does the model capture the elevated costs during the transition from voice to a broadband network when parallel systems must be operated and maintained. As a practical matter and given the focus of HCL on broadband, the absence of any measure of broadband deployment as a cost variable of the QRA is a glaring deficiency.

Operating Taxes

Operating Taxes include property taxes, operating investment tax credits, state and federal income taxes, deferred operating taxes, and other such amounts. The HCLS Benchmark Order included Operating Taxes as a benchmarked cost because "taxes are an expense that must be paid, just like other operational expenses". This is flawed reasoning and the Commission should reconsider this issue. The QRA was designed to compare costs of rural companies in order to develop benchmarks for costs. Yet, operating tax expenses cannot be compared between companies because they are determined by investment state and local taxing authorities and corporate form and not by operating variables such as number of lines or road miles.

For example, EATEL is a relatively large rural local exchange carrier incorporated in the state of Louisiana and organized under Subchapter –S of the Internal Revenue Code. As a consequence, EATEL's shareholders incur an effective combined state and federal income tax rate of over 44%. Compare that to a small co-operative carrier in the state of Texas which would have a combined income tax rate of 0%. Furthermore, the amount of Operating Taxes incurred by EATEL is completely out of the company's

control. No management decision or operating efficiency will change the federal or Louisiana income tax rates.

Based on our analysis, the improper inclusion of Operating Taxes in the QRA results in over $7.5 million of lost annual HCL support to EATEL. I do not believe that our proper payment of federal, state and local income taxes and property taxes should be deemed as "excessive" costs. Furthermore, the Commission should not utilize a statistical model that uses non-comparable inputs and uncontrollable costs. Operating tax amounts should not be included in the benchmarking process but rather should be included in the calculation of recoverable costs *after* any limits are imposed.

Depreciation Expense

Instead of benchmarking the actual asset costs of cable and circuit equipment, the FCC defined the capital costs (capex) as depreciation expense of subscriber cable and wire facility ("CWF") and subscriber circuit equipment plus the return on investment component. This appears to be short-cut method that allows the use of the National Exchange Carrier Association HCL Algorithm as QRA inputs. The problem with using depreciation expense as opposed to asset values as a measure of capital investment is that it introduces depreciation rates into the equation. Depreciation rates are arbitrary amounts set by state public utility commissions and vary widely from state to state. As such, the use of depreciation expense makes it impossible to properly compare capital expenditures between companies. For example, the Louisiana Public Utility Commission has authorized higher allowed depreciation rates than most other states. EATEL's depreciation rates for central office transmission equipment and cable and wire facility are 15.6% and 6.70%, respectively. If we had a theoretical company, let's call it B-TEL, that was exactly the same as EATEL in all aspects – costs, lines, road miles, climate, etc. – but was situated in a different state with 50% lower depreciation rates, it would appear to the QRA that B-TEL needs only half the capital investment that EATEL needs to serve exactly the same area. However, we know from our example that this isn't the actual case. Once again, EATEL is being unfairly penalized because the QRA does not recognize that we are located in a state with higher depreciation rates.

Allocated Costs

As just discussed, the QRA uses the National Exchange Carrier Association HCL Algorithm inputs as proxies for the costs of capital expenditures and operating expenses. However, the operating expenses in the algorithm are not the "whole" costs but rather allocated amounts. The HCL Algorithm calculates allocation factors that attribute portions of the expenses to the subscriber (or common line) network. The use of these allocated numbers once again skews the comparability of costs between companies. Unfortunately, this flaw in the QRA also works against EATEL. A quick analysis of the 12-1 HCL Data shows that EATEL has a significantly higher percentage of common line investment than the average:

	Common Line Cable & Wire	Subscriber Circuit
EATEL	96.8424%	64.6079%
Average	89.0905%	39.7531%

These common line allocation amounts are determined by network architecture needs and 47 CFR Part 36 Separations Rules and are largely out of each company's control. Once again, if we compare EATEL with our theoretical identical company B-TEL and the only difference is the allocation to common line, it

will appear to the QRA that EATEL's costs are as much as 25% higher than B-TEL even though their actual operating expenses are exactly the same.

Conclusion

In summary, EATEL is an efficient company that has made prudent investment choices to further the Commission's broadband and universal service goals. However, the current benchmarking methodology does not provide fair and equitable comparisons between companies and therefore produces anomalous results. The QRA should be modified or replaced with a statistical analysis that provides valid comparisons of company operations and considers such important factors as network architecture needs and a measure of broadband availability. Furthermore, benchmarking should be focused on actual deployment and operating costs than can be managed and should not include arbitrary and uncontrollable amounts such as operating taxes, depreciation rates, and allocations.

I hope that this letter providing you with an operator's perspective gives you more insight into the challenges and the need to engage in additional dialogue as you identify costs that are prudent in serving customers.

Sincerely,

John D. Scanlan
President & Vice Chairman

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